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"Our focus and resources are clearly aligned to drive our strength—digital video networking applications—and we expect to continue to deliver top line growth that will achieve net income profits and positive cash flow," said Mark Richman, Terayon Chief Financial Officer. "Our restructuring activities and increased focus on operational cost management in 2005 support this drive to net income."
[Emphasis added.]

198. Later the same day, on May 3, 2005, defendants also conducted a conference call for analysts and investors, hosted by defendants Richman and Chase. During this call, defendant Chase stated, in part, the following:

JERRY CHASE, CEO, TERAYON COMMUNICATION SYSTEMS: Thanks, Mark. Hello, everyone, and thank you for joining us for Terayon's Q1 2005 earnings conference call. ***As you can see from our earnings press release issued earlier today, Terayon had a good first quarter, showing notable progress in moving digital video to the center of our corporate strategy. In addition, we took important steps toward sustainable profitability.*** Let's begin our update with digital video applications.

* * *

While there is much work to be done, we are pleased with our progress during the first quarter. A strong second quarter pipeline indicates continued growth as we remain focused on driving to sustainable profits and positive cash flow. To do this, we will continue to invest in digital video, to strengthen our current cable market leadership position, and grow across associated vertical markets like satellite, broadcast and Telco. We'll build on our market-leading digital video applications, particularly in the area of advertising. We'll expand our strong video partner program to integrate our solutions into new types of video systems and markets, and we'll manage our home access business to re-establish profitable growth and cash contributions. ***By executing on these objectives, we expect to continue healthy improvements.*** [Emphasis added.]

199. During this call, defendant Richman also stated, in part, the following:

MARK RICHMAN: Thank you, Jerry. ***I am very pleased to announce that we have met or exceeded all previously-announced financial guidance for the first quarter of 2005. We report net revenues of \$26.4 million down from \$29.4 million in the fourth quarter of 2004.*** Most importantly, we grew our digital video revenue in the first quarter of 2005 to our record \$13 million, despite capital expenditure patterns that often experience reduced Q4 to Q1 CapEx activity. In addition, we launched the 7600G, and while we did not ship or record revenues in the first quarter, demand for the 7600G should support continued revenue growth beginning in the second quarter 2005.

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Our net loss in the first quarter of 2005 was \$2.6 million or \$0.03 per share, compared to \$7.9 million or \$0.10 per share in the fourth quarter of 2004.

Excluding the previously mentioned benefits of a reversal of warranty reserves and bad debt recoveries, we would have recorded a net loss of approximately \$3.7 million or \$0.05 a share, which we believe is a better indicator of our current period performance. ***This still compares favorably to our previously-announced guidance of a loss from \$3 to \$6 million.*** [Emphasis added.]

200. As a direct result of the statements made or published by defendants, the following day, May 4, 2005, *MarketWatch.com* reported that Terayon shares soared. According to this report, shares of Terayon rose 17%, to \$3.22 per share, in afternoon trading Wednesday after the Company posted overnight a narrower-than-expected first-quarter loss. The perceived improvement in its performance prompted brokerage Merriman Curhan Ford & Co. to upgrade the Company to "Buy" from "Neutral," citing optimism over the value, growth and earnings power of its digital video unit. The Thomson First Call average estimate was for a loss of four cents a share on revenues of \$27.9 million.

10-Q for First Quarter 2005

201. On or about May 10, 2005, defendants filed with the SEC the Company's Form 10-Q for the quarter ended March 31, 2005 ("1Q:05 Form 10-Q"), signed by defendant Richman and certified by defendants Richman and Case. In addition to making substantially similar statements concerning the Company's procedures and its financial operations as had been made by defendants previously, the 1Q:05 Form 10-Q also stated, in part, the following:

The accompanying condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X.... ***In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of the condensed consolidated financial statements at March 31, 2005 and for the three months ended March 31, 2005 and 2004 have been included.*** [Emphasis added.]

202. The Company's 1Q:05 Form 10-Q also reported Terayon's Liquidity and Capital Resources, in part, as follows:

At March 31, 2005, we had approximately \$30.6 million in unrestricted cash and cash equivalents and \$69.2 million in short-term investments.

1 ***In July 2000, we issued \$500.0 million of Notes, resulting in net proceeds to us of***
 2 ***approximately \$484.4 million. The Notes are a general unsecured obligation and***
 3 ***are subordinated in right of payment to all of our existing and future senior***
 4 ***indebtedness and to all of the liabilities of our subsidiaries.*** The Notes are
 5 convertible into shares of our common stock at a conversion price of \$84.01 per
 share at any time on or after October 24, 2000 through maturity, unless previously
 redeemed or repurchased. Interest is payable semi-annually. ***Debt issuance costs***
related to the Notes were approximately \$15.6 million. The Notes mature in August
 2007.

6 Through March 31, 2005, we had repurchased approximately \$434.9 million of the
 7 Notes for \$171.0 million in cash and \$17.9 million in stock, resulting in a gain on
 8 early retirement of debt of approximately \$234.4 million net of related unamortized
 issuance costs of \$11.6 million in prior periods. No Notes were repurchased in 2003,
 2004, or 2005. [Emphasis added.]

9 203. In addition to the foregoing, the Company's 1Q:05 Form 10-Q also contained
 10 statements that attested to the purported sufficiency of Terayon's controls and procedures. While
 11 the 1Q:05 Form 10-Q did again acknowledge certain defects in the Company's communications
 12 protocols, the 1Q:05 Form 10-Q also reported that these problems had been substantially resolved
 13 and that, following a review of the Board of Directors, the Company's internal controls and
 14 procedures were reasonably adequate. As evidence of this, the 1Q:05 Form 10-Q also stated, in
 15 part, the following:

16 Under the supervision and with the participation of our senior management,
 17 including our CEO and CFO, we conducted an evaluation of the effectiveness of the
 design and operation of our disclosure controls and procedures as of March 31, 2005.
 18 ***Based on that evaluation, as of the date of the evaluation, our management,***
 19 ***including our CEO and CFO, concluded that our disclosure controls and***
 20 ***procedures were not effective as of March 31, 2005 because of the material***
weakness described below. We have already implemented, and will continue to
implement, corrective actions with respect to this material weakness, as further
described below.

21 * * *

22 As part of the evaluation of our disclosure controls and procedures as of March 31,
 23 2005, we determined that we have remediated the material weakness related to our
 24 procedures and controls over the preparation and review of our consolidated financial
 statements and accompanying footnote disclosures contained in this Quarterly Report
 25 on Form 10-Q. ***The insufficient controls, which were originally identified during***
the preparation of the Annual Report on Form 10-K, included a lack of sufficient
personnel with technical accounting expertise in our finance department and
inadequate review and approval procedures to prepare external financial
 26 ***statements in accordance with GAAP. As a result of the new procedures and***
 27 ***controls we implemented for the preparation and review of this Quarterly Report***
on Form 10-Q and the remediation steps described below, we believe we have

1 remediated this material weakness. Senior management will continue to monitor the
 2 technical accounting expertise of finance personnel staff closely to ensure that
 adequate review and approval of our financial statements is maintained.

3
 4 As part of the same evaluation, we determined, however, that we have not completed
 implementation of the changes we believe are required to remediate the previously
 5 reported material weakness related to the inadequacy of communication between our
 senior management and the finance department. During their review of our interim
 6 financial results for the three months ended March 31, 2005, our independent
 registered public accounting firm identified two significant adjustments to our
 7 financial statements as part of their quarterly review procedures. These two
 adjustments were the result of the continued lack of communication within the
 8 Company with regards to certain severance obligations and our policy for the
 allowance for doubtful accounts. *These two adjustments were corrected prior to the*
issuance of our financial statement for the three months ended March 31, 2005.
 9 [Emphasis added.]

10 204. In addition to the foregoing, the 1Q:05 Form 10-Q also contained a series of
 11 statements that purported to attest to the fact that the Company had *already* remediated the control
 12 weaknesses and other problems that were then adversely impacting the Company, including that:

13 Remediation Steps

14 During the quarter ended March 31, 2005 and through to the date of the filing of this
 15 Form 10-Q, and in response to the material weaknesses identified as of December 31,
 2004, we implemented the following steps to remediate the deficiencies in our
 16 disclosure controls and procedures and material weaknesses in our internal control
 over financial reporting.

17 (i) Established procedures to document the review of press releases to
 18 account for transactions in a complete and timely manner;

19 (ii) Engaged the former Assistant Controller, who has significant SEC
 reporting experience, to serve as our Controller, in part to supervise our financial
 reporting to ensure compliance with SEC requirements;

20 (iii) Promoted our Consolidations Reporting Manager to Director of
 21 Accounting to provide greater individual management of all accounting functions;
 and

22 (iv) Improved our internal process of drafting and reviewing periodic reports
 23 by implementing additional management and external legal counsel review prior to
 their submission to our independent registered public accounting firm.

24
 25 Moreover, we intend to implement the following additional remediation steps to
 26 address the material weakness related to the inadequacy of communication between
 our senior management and the finance department;

(i) Continue to monitor the communication channels between our senior management and our finance department and take prompt action, as necessary, to further strengthen these communication channels;

(ii) Increase staffing in the finance department;

(iii) Re-allocate duties to persons within the finance organization to maximize their skills and experience;

(iv) Implement training procedures for new employees and/or consultants in the finance department on our disclosure procedures and controls, our Company and our actions in previous reporting periods; and

(v) Take steps to ensure that our senior management has timely access to all material financial and non-financial information concerning our business.

Changes in internal control over financial reporting.

Other than as described above, there has been no change in our internal control over financial reporting during our most recently completed fiscal quarter that has materially affected or is likely to materially affect our internal control over financial reporting. [Emphasis added.]

205. Again, the statements concerning the Company's controls and procedures was also critically important to investors as a result of the related-party nature of a material amount of the Company's revenues. Accordingly, the Company's 1Q:05 Form 10-Q described these related party transactions, in part, as follows:

Related Party Transactions

Lewis Solomon, a member of the Company's Board of Directors is also a member of the Board of Directors of Harmonic, Inc. (Harmonic). Harmonic is an authorized, non-exclusive reseller of certain of the Company's video products. For the three months ended March 31, 2005 and March 31, 2004, related party revenue from Harmonic was \$8.8 million and \$0.7 million, respectively.

Cost of related party revenues in the Company's consolidated statements of operations consists of direct and indirect costs. Accounts receivable from Harmonic totaled approximately \$6.4 million at March 31, 2005. Harmonic is not a supplier to the Company.

SOX Certifications for 1Q:05 Form 10-Q

206. The 1Q:05 Form 10-Q also contained SOX signed by defendants Chase and Richman and filed with the SEC. These Certifications stated, in part, "*the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company at the dates and for the periods indicated.*" [Emphasis added.]

207. The statements made by defendants and contained in the Company's May 3, 2005 press release, those statements made by defendants during the quarterly conference call, and those statements contained in Terayon's 1Q:05 Form 10-Q, were each materially false and misleading and were known by defendants to be false at that time, or were recklessly disregarded as such, for the reasons stated herein in ¶ 64.

July 28, 2005 Release and Conference Call Announcing Results for 2Q:05

208. On July 28, 2005, Terayon published a release announcing results for the second quarter ended June 30, 2005 – the fifth purported consecutive quarter of increasing revenues. This release reported quarterly financial information about the Company, in part, as follows:

Terayon Reports Second Quarter 2005 Results; Digital Video Applications Revenue Grows to a Record \$17.3 Million for the Quarter, Increasing for the Fifth Consecutive Quarter

Revenue for the second quarter of 2005 was \$29.5 million, a 12% increase compared to \$26.4 million for the first quarter of 2005 and down 31% compared to \$42.8 million for the second quarter of 2004.

* * *

Net loss for the second quarter of 2005 was \$508,000, or \$0.01 per share, compared to a net loss of \$2.6 million, or \$0.03 per share, for the first quarter of 2005 and a net loss of \$4.9 million, or \$0.06 per share, for the second quarter of 2004.

209. Commenting on the purported strength and financial operations of the Company, the July 28, 2005 release also quoted defendants Chase and Richman, in part, as follows:

"Second quarter results indicate solid progress in moving digital video to the center of our corporate strategy," said Jerry Chase, Terayon Chief Executive Officer. "The second quarter marks the fifth consecutive quarter of record revenue for our digital video solutions. We believe this is due to Terayon's unique ability to address fundamental changes occurring in the market."

* * *

"Our digital video revenue growth coupled with reduced operating expenses positions us closer to our goal of profitability," said Mark Richman, Terayon Chief Financial Officer. "Our focus remains on execution to drive revenues and asset and expense management to drive net income profitability." [Emphasis added.]

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1 210. Later the same day, defendants also conducted a conference call for analysts and
 2 investors, hosted by defendants Richman and Chase. During this call, defendant Chase stated, in
 3 part, the following:

4 **JERRY CHASE, CEO, TERAYON COMMUNICATION SYSTEMS:** Thank you,
 5 Mark, and hello everyone. Thank you for joining us for the call. Earlier this
 6 afternoon, we released our second quarter results. I am pleased with the ongoing
 7 progress we are making towards executing on a unique market position that is
 8 driving us towards profitability. We are fortunate that market factors continue to
 9 trend in our direction. We have become a solid player in real time digital video
 10 networking applications and our product quality across our video and home access
 product lines remain high. *Terayon has achieved a number of milestones this past
 quarter, including video revenues were up for the fifth straight quarter to 17.3
 million, giving us the best video quarter we've ever had. We are cash flow positive
 for the second consecutive quarter, indicative of an increased focus on asset and
 expense management, and customer diversification continues to improve each
 quarter.*

11 * * *

12 With the market trends moving toward what we do best, coupled with a steady focus
 13 on strengthening customer relationships, broadening customer diversity, delivering
 new product innovations and building a stronger partner channel, *Terayon has made
 steady and solid progress against our digital video goals this past quarter.*

14 * * *

15 *The second quarter has been a good one for us and we are confident in our ability
 16 to continue this progress.* Market trends continue to shift toward what Terayon does
 17 best and we are in a great position to capture the opportunity. The initial phase of
 Comcast digital simulcast projects has generated not only sales but also strengthened
 18 our relationship with them. We are winning new customers and expanding our
 business within our current base. We expect all these trends will continue over the
 19 long run as the job of building revenue producing all digital networks is at the
 beginning of the cycle. We do expect a small fall-off in demand in the third quarter
 20 as our customers absorb what they have bought and now must implement. This is a
 timing issue, not a demand issue. We expect orders from Comcast to be lower in the
 21 third quarter. However, it will be offset slightly through sales to other MSOs which
 also diversify their customer base. *We are winning market share and expect that
 trend to continue in the third quarter despite the projected small decline in
 22 revenue.*

23 * * *

24 **JERRY CHASE:** *Thank you, Mark. Our second quarter results certainly indicate
 25 the effectiveness of our plan and execution to date. I am optimistic about our
 ability to maintain its focus and deliver favorably against our business plan.* Our
 26 customers have honored us by making us a vendor in high standing and our products
 earned high marks for their excellent performance in quality. While there's always
 27 more to be done, Mark and I look forward to providing you with updates on our
 progress as we continue to transition Terayon to a digital video company. [Emphasis
 28 added.]

211. During this call, defendant Richman also stated, in part, the following:

MARK RICHMAN: Thank you, Jerry. *I am very pleased to announce that we have met or exceeded all previously announced financial guidance for the second quarter of 2005 and reporting second quarter revenues of 29.5 million, we have returned to top line growth, up from 26.4 million in the first quarter of 2005. Most importantly, we grew our digital video revenue in the second quarter of 2005 to a record 17.3 million, up from 13 million in the first quarter.* This growth was in large part attributable to market acceptance of our CP 7600G edge decoder that contributed 6.6 million of revenues in Q2. The CP 7600G revenue contribution exceeded expectations reflecting the growing trend of building out all digital networks.

* * *

Our net loss in the second quarter was near break-even at half a million dollars, or \$0.01 per share compared to a loss of 2.6 million or \$0.03 per share in the first quarter of 2005.

* * *

As a final comment and as we will shortly announce in an SEC 8-K filing, *we were recently advised by Ernst and Young that it resigned as the Company's independent registered public accounting firm effective upon the completion of services related to the review of the Company's interim financial statements for the quarter ending September 30th, 2004. While we consider this development to be unfortunate, we understand that Terayon and other companies are losing the services of a Big 4 accounting firm.* We are immediately working to resolve this issue and our audit committee and management have commenced the search for a new, independent registered public accountant. *This development will not impact our market opportunities and will not diminish the confidence and optimism that we have with regard to our business prospects. I would like to thank you for listening and will now turn the call back to Jerry.* [Emphasis added.]

212. The statements made in the July 28, 2005 release and conference call were false and misleading for the reasons set forth at ¶ 64. The statement in the conference call that "Terayon and other companies are losing the services of a Big 4 accounting firm" is also false and misleading because it implies that the reason for the departure of Ernst & Young is not related to Terayon's massive accounting irregularities, GAAP violations, and the like, but rather simply stems from the fact that the "Big 4" cannot service Terayon and other companies.

August 1, 2005 8-K Regarding Sudden Resignation of Ernst & Young

213. On August 1, 2005, defendants filed with the SEC pursuant to Form 8-K, a report announcing that Terayon had retained a new Independent Auditor. Of critical importance to investors, at that time, this report stated that the *selection of its new auditors did not result from*

1 *any disagreement or problem with its prior auditors, Ernst & Young.* The Company's August 1,
2 2005 form 8-K, signed by Defendant Richman, stated, in substantial part, the following:

3 **Item 4.01. Changes in Registrant's Certifying Accountant.**

4 On July 26, 2005, Terayon Communication Systems, Inc. (the "Company"), was
5 advised by Ernst & Young LLP ("Ernst & Young") that Ernst & Young will resign as
6 the Company's independent registered public accounting firm following the earlier of
7 the completion of services related to the review of the Company's interim financial
8 statements for the quarter ending September 30, 2005 or the filing due date of that
9 quarterly report.

10 *The reports of Ernst & Young on the Company's financial statements as of and*
11 *for the years ended December 31, 2004 and 2003 did not contain an adverse*
12 *opinion or a disclaimer of opinion and were not qualified or modified as to*
13 *uncertainty, audit scope, or accounting principles.*

14 *In connection with the audits of the Company's most recent two years ended*
15 *December 31, 2004 and 2003 and in the subsequent interim period, there were no*
16 *disagreements (as described under Item 304(a)(1)(iv) of Regulation S-K) between*
17 *Ernst & Young and the Company on any matter of accounting principles or*
18 *practices, financial statement disclosure, or auditing scope and procedures, that, if*
19 *not resolved to the satisfaction of Ernst & Young, would have caused Ernst &*
20 *Young to make reference to the subject matter of the disagreement in connection*
21 *with its reports on the Company's financial statements for such years.*

22 *During the years ended December 31, 2004 and 2003, and through July 26, 2005,*
23 *there were no "reportable events" as described in Item 304(a)(1)(v) of Regulation*
24 *S-K, other than the two material weaknesses disclosed in the Company's Form 10-*
25 *K filed on March 15, 2005 and as described below:*

26 First, management identified a material weakness due to insufficient controls related
27 to the identification, capture, and timely communication of financially significant
28 information between certain parts of the organization and the finance department to
enable the finance department to account for transactions in a complete and timely
manner. As a result of this material weakness, management recorded an adjustment
in the quarter ended September 30, 2004 to record termination benefits paid to a
former executive.

Second, management also identified a material weakness for insufficient controls
related to the preparation and review of the annual consolidated financial statements
and accompanying footnote disclosures. The insufficient controls include a lack of
sufficient personnel with technical accounting expertise in the finance department
and inadequate review and approval procedures to prepare external financial
statements in accordance with generally accepted accounting principles (GAAP). As
a result of this material weakness, management made substantial revisions to its 2004
annual consolidated financial statements and footnote disclosures before they were
issued.

1 *Ernst & Young did not seek the Company's consent to its resignation. As a result,*
 2 *the Company's audit committee did not recommend or approve the resignation of*
 3 *Ernst & Young.*

4 The Company has provided Ernst & Young with a copy of the foregoing disclosures
 5 and requested that Ernst & Young furnish a letter to the Securities and Exchange
 6 Commission stating whether or not Ernst & Young agrees with the above statements.
 7 Ernst & Young furnished such a letter, dated August 1, 2005, a copy of which is
 8 attached hereto as Exhibit 16.1.

9 The Company's audit committee has commenced the process of selecting an
 10 independent registered public accounting firm to replace Ernst & Young.
 11 [Emphasis added.]

12 214. Also attached to the Company's September 28, 2005 Form 8-K was an August 1,
 13 2005 letter from Ernst & Young to the SEC (Office of Chief Accountant), that stated the following:

14 *We have read Item 4.01 of Form 8-K dated July 26, 2005, of Terayon*
 15 *Communication Systems, Inc. and are in agreement with the statements contained*
 16 *in paragraphs 1 through 6 and the first sentence of paragraph 7 on page 2 therein.*
 17 *We have no basis to agree or disagree with other statements of the registrant*
 18 *contained therein.*

19 *Regarding the registrant's statements concerning the lack of internal control to*
 20 *prepare financial statements, included in paragraphs 4 through 6 on page 2*
 21 *therein, we had considered such matters in determining the nature, timing and*
 22 *extent of procedures performed in our audit of the registrant's 2004 financial*
 23 *statements.* [Emphasis added.]

24 Form 10-Q for Second Quarter 2005

25 215. On or about August 9, 2005, defendants filed with the SEC the Company's Form 10-
 26 Q for the quarter ended June 30, 2005 ("2Q:05 Form 10-Q"), signed by defendant Richman and
 27 certified by defendants Richman and Case. In addition to making substantially similar statements
 28 concerning the Company operations and its financial operations as had been made by defendants
 previously, the 2Q:05 Form 10-Q also stated, in part, the following:

2. **Summary of Significant Accounting Policies**

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared
 in accordance with U.S. generally accepted accounting principles for interim
 financial information and in accordance with the instructions to Form 10-Q and
 Article 10 of Regulation S-X.... *In the opinion of management, all adjustments*
(consisting of normal recurring adjustments) necessary for a fair presentation of

1 *the condensed consolidated financial statements at June 30, 2005 and for the three*
 2 *and six months ended June 30, 2005 and 2004 have been included.* [Emphasis
 added.]

3 216. The Company's 2Q:05 Form 10-Q also reported Terayon's Liquidity and Capital
 4 Resources, in part, as follows:

5 At June 30, 2005, we had approximately \$38.6 million in unrestricted cash and cash
 6 equivalents and \$66.4 million in short-term investments.

7 *In July 2000, we issued \$500.0 million of Notes, resulting in net proceeds to us of*
approximately \$484.4 million. The Notes are a general unsecured obligation and are
 8 subordinated in right of payment to all of our existing and future senior indebtedness
 9 and to all of the liabilities of our subsidiaries. The Notes are convertible into shares
 of our common stock at a conversion price of \$84.01 per share at any time on or after
 October 24, 2000 through maturity, unless previously redeemed or repurchased.
 Interest is payable semi-annually. *Debt issuance costs related to the Notes were*
 10 *approximately \$15.6 million.* The Notes mature in August 2007.

11 *Through June 30, 2005, we had repurchased approximately \$434.9 million of the*
Notes for \$171.0 million in cash and \$17.9 million in stock, resulting in a gain on
 12 *early retirement of debt of approximately \$234.4 million* net of related unamortized
 issuance costs of \$11.6 million in prior periods. No Notes were repurchased in 2003,
 13 2004, or 2005. [Emphasis added.]

14 217. The Company's 1Q:05 Form 10-Q also contained statements that attested to the
 15 purported adequacy of Terayon's controls and procedures. While the 1Q:05 Form 10-Q did
 16 acknowledge certain minor defects in its communications protocols, the 1Q:05 Form 10-Q also
 17 reported that these problems had been substantially remedied and that, following a review of the
 18 Board of Directors, the Company's internal controls and procedures continued to be reasonably
 19 adequate. As evidence of this, the 1Q:05 Form 10-Q also stated, in part, the following:

20 *Under the supervision and with the participation of our senior management,*
 21 *including our CEO and CFO, we conducted an evaluation of the effectiveness of*
 22 *the design and operation of our disclosure controls and procedures as of June 30,*
2005. Based on that evaluation, as of the date of the evaluation, our management,
 23 *including our CEO and CFO, concluded that our disclosure controls and*
procedures were effective as of June 30, 2005.

24 * * *

25 *As part of the evaluation of our disclosure controls and procedures as of June 30,*
 26 *2005, we determined that we have remediated the material weakness related to our*
 27 *procedures and controls over the preparation and review of our consolidated*
 28 *financial statements and accompanying footnote disclosures contained in this*
Quarterly Report on Form 10-Q. The insufficient controls, which were originally
 identified during the preparation of the Annual Report on Form 10-K, included a lack
 of sufficient personnel with technical accounting expertise in our finance department
 and inadequate review and approval procedures to prepare external financial

1 statements in accordance with GAAP. *As a result of the new procedures and*
 2 *controls we implemented for the preparation and review of this Quarterly Report*
 3 *on Form 10-Q and the remediation steps described below, we believe we have*
 4 *remediated this material weakness.* Senior management will continue to monitor the
 technical accounting expertise of finance personnel staff closely to ensure that
 adequate review and approval of our financial statements is maintained.

5 During their review of our interim financial results for the three months ended March
 6 31, 2005, our independent registered public accounting firm identified two
 7 significant adjustments to our financial statements as part of their quarterly review
 8 procedures. These two adjustments were the result of the continued lack of
 9 communication within the Company with regards to certain severance obligations
 10 and our policy for the allowance for doubtful accounts. These two adjustments were
 11 corrected prior to the issuance of our financial statements for the three months ended
 12 March 31, 2005. *As part of an evaluation we conducted at June 30, 2005, we*
 13 *determined, however, that we have completed implementation of the changes we*
 14 *believe are required to remediate the previously reported material weakness related*
 15 *to the inadequacy of communication between our senior management and the*
 16 *finance department, which caused these two adjustments.*

12 Remediation Steps

13 During the quarter ended June 30, 2005 and through to the date of the filing of this
 14 Form 10-Q, and in response to the material weaknesses identified as of December 31,
 2004 and March 31, 2005, we implemented the following steps to remediate the
 deficiencies in our disclosure controls and procedures and material weaknesses in our
 internal control over financial reporting.

16 (i) Established procedures to document the review of press releases to
 17 account for transactions in a complete and timely manner;

18 (ii) Engaged the former Assistant Controller, who has significant SEC
 19 reporting experience, to serve as our Controller, in part to supervise our financial
 reporting to ensure compliance with SEC requirements;

20 (iii) Promoted our Consolidations Reporting Manager to Director of
 21 Accounting to provide greater individual management of all accounting functions;
 and

22 (iv) Improved our internal process of drafting and reviewing periodic
 23 reports by implementing additional management and external legal counsel review
 prior to their submission to our independent registered public accounting firm.

24 Moreover, we implemented the following additional remediation steps to address the
 25 material weakness related to the inadequacy of communication between our senior
 management and the finance department;

26 (i) Continue to monitor the communication channels between our senior
 27 management and our finance department and take prompt action, as necessary, to
 28 further strengthen these communication channels;

(ii) Increase staffing in the finance department;

(iii) Re-allocate duties to persons within the finance organization to maximize their skills and experience;

(iv) Implement training procedures for new employees and/or consultants in the finance department on our disclosure procedures and controls, our Company and our actions in previous reporting periods; and

(v) Take steps to ensure that our senior management has timely access to all material financial and non-financial information concerning our business.

Changes in internal control over financial reporting. Other than as described above, there has been no change in our internal control over financial reporting during our most recently completed fiscal quarter that has materially affected or is likely to materially affect our internal control over financial reporting. [Emphasis added.]

218. Again the statements concerning the Company's controls and procedures were of critical important to investors, as a result of the related-party nature of a material amount of the Company's revenues. Accordingly, the Company's 1Q:05 Form 10-Q again described these related party transactions, in part, as follows:

Related Party Transactions

Lewis Solomon, a member of the Company's Board of Directors is also a member of the Board of Directors of Harmonic, Inc. (Harmonic). Harmonic is an authorized, non-exclusive reseller of certain of the Company's video products. For the six months ended June 30, 2005 and June 30, 2004, related party revenue from Harmonic was \$13.7 million and \$3.4 million, respectively.

Cost of related party revenues in the Company's consolidated statements of operations consists of direct and indirect costs. Accounts receivable from Harmonic totaled approximately \$2.3 million at June 30, 2005. Harmonic is not a supplier to the Company.

SOX Certifications for Form 10-Q for First Quarter 2005

219. The 1Q:05 Form 10-Q also contained SOX Certifications signed by defendants Chase and Richman, and filed with the SEC. These Certifications stated, in part "*the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company at the dates and for the periods indicated.*" [Emphasis added.]

220. The statements made by defendants contained in Terayon's 2Q:05 Form 10-Q and its August 1, 2005 Form 8-K, were each materially false and misleading and were know by defendants to be false at that time, or were recklessly disregarded as such, for the reasons stated herein in ¶ 64.

September 27, 2005 8-K re: Change of Independent Auditor

221. On September 27, 2005, defendants filed with the SEC pursuant to Form 8-K, in part, the following statement regarding the change of Terayon's independent auditors:

Item 4.01. Changes in Registrant's Certifying Accountant.

(a) As previously disclosed by Terayon Communication Systems, Inc. (the "Company") in its Current Report on Form 8-K filed on August 1, 2005, the Company's former independent registered public accounting firm, Ernst & Young LLP, ("Ernst & Young") informed the Company that it would resign as the Company's independent registered public accounting firm effective upon the earlier of completion of services related to the review of the Company's interim financial statements for the quarter ending September 30, 2005 or the filing due date of that quarterly report. Ernst & Young did not seek the Company's consent to its resignation. As a result, the Company's Audit Committee did not recommend or approve the resignation of Ernst & Young.

On August 9, 2005, the Company filed its Quarterly Report on Form 10-Q for the quarter ended June 30 2005. Ernst & Young served as the Company's independent registered public accounting firm in reviewing the Company's interim financial statements for the quarter ended June 30, 2005 for purposes of that quarterly report.

On September 21, 2005, the Audit Committee of the Board of Directors of the Company engaged Stonefield Josephson, Inc. ("Stonefield Josephson") as the Company's new independent registered public accounting firm to audit the Company's financial statements for the fiscal year ended December 31, 2005, and to perform certain procedures related to the financial statements to be included in the Company's quarterly reports on Form 10-Q. Effective as of such date, Ernst & Young resigned as the Company's independent registered public accounting firm.

The reports of Ernst & Young on the Company's financial statements as of and for the years ended December 31, 2004 and 2003 did not contain an adverse opinion or a disclaimer of opinion and were not qualified or modified as to uncertainty, audit scope, or accounting principles.

In connection with the audits of the Company's most recent two years ended December 31, 2004 and 2003 and in the subsequent interim periods, there were no disagreements (as described under Item 304(a)(1)(iv) of Regulation S-K) between Ernst & Young and the Company on any matter of accounting principles or practices, financial statement disclosure, or auditing scope and procedures, that, if not resolved to the satisfaction of Ernst & Young, would have caused Ernst & Young to make reference to the subject matter of the disagreement in connection with its reports on the Company's financial statements for such years.

1 *During the years ended December 31, 2004 and 2003, and through September 21,*
 2 *2005, there were no "reportable events" as described in Item 304(a)(1)(v) of*
 3 *Regulation S-K, other than the two material weaknesses disclosed in the*
Company's Annual Report on Form 10-K filed on March 15, 2005 and as described
 below:

4 * * *

5 *The Company has provided Ernst & Young with a copy of the foregoing*
 6 *disclosures and requested that Ernst & Young furnish a letter to the Securities and*
 7 *Exchange Commission stating whether or not Ernst & Young agrees with the above*
statements. Ernst & Young furnished such a letter, dated September 23, 2005, a copy
 of which is attached hereto as Exhibit 16.1.

8 (b) On September 21, 2005, the Audit Committee of the Board of
 9 Directors of the Company engaged Stonefield Josephson as the Company's new
 10 independent registered public accounting firm to audit the Company's financial
 11 statements for the fiscal year ended December 31, 2005, and to perform certain
 12 procedures related to the financial statements to be included in the Company's
 13 quarterly reports on Form 10-Q. The Company did not consult Stonefield Josephson
 on any matter or event described in Item 304(a)(2)(i) or (ii) of Regulation S-K during
 the Company's two most recent fiscal years and through September 21, 2005, the
 effective date of the Company's engagement of Stonefield Josephson. [Emphasis
 added.]

14 222. Also attached to the Company's September 28, 2005 Form 8-K was a September 23,
 15 2005 letter from Ernst & Young to the SEC, that stated, in relevant part:

16 We have read Item 4.01 of Form 8-K dated September 21, 2005, of Terayon
 17 Communication Systems, Inc. and are in agreement with the statements contained in
 18 the first and second sentences of paragraph 1, the second sentence of paragraphs 2
 and 3, and paragraphs 4 through 8 on page 2 therein. *We have no basis to agree or*
disagree with other statements of the registrant contained therein.

19 *Regarding the registrant's statements concerning the lack of internal control to*
 20 *prepare financial statements, included in paragraphs 6 through 8 on page 2*
 21 *therein, we had considered such matters in determining the nature, timing and*
extent of procedures performed in our audit of the registrant's 2004 financial
statements. [Emphasis added.]

22 September 30, 2005 Release re: Change in Independent Auditor

23 223. On September 30, 2005, defendants published a release announcing that Terayon had
 24 retained a new independent auditor. This release stated that its new auditors were an "excellent fit,"
 25 and again defendants implied that this change was *not the result of any disagreement or problem*
 26 *with its prior auditors, Ernst & Young.* Accordingly, as evidence of this, the Company's
 27 September 30, 2005 release stated, in substantial part, the following:

1 **Terayon Signs New Independent Auditor**

2 Terayon Communication Systems, Inc. (NASDAQ:TERN), a leading provider of
3 digital video networking applications and home access solutions, today announced
4 that it engaged Stonefield Josephson, Inc., a Santa Monica-based accounting firm
5 with Bay Area offices, as the company's new independent auditor effective
6 September 21, 2005.

7 "Through our extensive search for an external audit firm with strong SEC experience,
8 we identified and signed Stonefield Josephson, which precisely meets our auditing
9 requirements," said Mark Richman, Terayon Chief Financial Officer. "Their full
10 range of audit services and Sarbanes-Oxley experience make them an excellent fit for
11 Terayon."

12 Stonefield Josephson will immediately take over responsibilities as the external
13 auditor beginning with the review of the Company's third quarter fiscal calendar.

14 224. The statements made by defendants and contained in the Company's September 30,
15 2005 press release, those statements made by defendants during the investor conferences, and those
16 statements contained in Terayon's Form 8-K, referenced above, were each materially false and
17 misleading and were know by defendants to be false at that time, or were recklessly disregarded as
18 such, for the reasons stated herein in ¶ 64.

19 **DEFENDANTS CONTINUE TO MAKE FALSE AND MISLEADING STATEMENTS** 20 **EVEN AFTER THE TRUTH SLOWLY BEGINS TO EMERGE**

21 225. Only weeks after Terayon replaced its auditors, on November 7, 2005, defendants
22 published a release announcing that the Company would delay the announcement and filing of its
23 third quarter financial results. At the same time, defendants also announced that certain revenues
24 from "a customer" *may have been recognized improperly and in violation of the Company's stated*
25 *revenue recognition policies.*

26 226. In this regard, the Company's November 7, 2005 release stated, in part, the
27 following:

28 **Terayon Announces Accounting Review and Delay in Release of Third Quarter 29 2005 Results**

30 Terayon Communication Systems, Inc. (NASDAQ: TERN), a leading provider of
31 digital video networking applications and home access solutions, *today announced*
32 *that it is reviewing the recognition of revenue for certain transactions during prior*
33 *periods. Terayon initiated the review after determining that certain revenues*
34 *recognized in the second half of fiscal year 2004 from a customer may have been*

1 *recorded in incorrect periods. The revenue matters under examination relate to the*
 2 *timing of revenue recognition and may result in a restatement of prior period*
 3 *financials.*

4 Pending completion of the accounting review, the filing of Terayon's Form 10-Q for
 5 the third quarter of fiscal year 2005 will be delayed, and this delay will extend
 6 beyond the Form 10-Q's filing deadline of November 9, 2005. Terayon also will
 7 delay the filing of its third quarter 2005 earnings release and conference call,
 8 originally scheduled for November 8, 2005.

9 *The accounting review includes an examination of whether a restatement of prior*
 10 *period financial statements may be required as it relates to the customer*
 11 *transactions in question, in addition to an examination of Terayon's revenue*
 12 *recognition policies and practices for current and past periods and an examination*
 13 *of Terayon's internal control over financial reporting as it relates to these items.*

14 There can be no assurance that Terayon or its independent auditors will not identify
 15 additional issues or other considerations in connection with the current review, and
 16 that these issues or considerations will not require further adjustments to the
 17 company's prior financial results for one or more prior fiscal years or quarters.

18 *"We are committed to accurate and transparent financial reporting and are taking*
 19 *this matter very seriously," said Jerry Chase, CEO, Terayon. "I want to emphasize*
 20 *that our cash position and market leadership remain strong and are not affected*
 21 *by the accounting issues under review. We remain focused on executing on our*
 22 *strategies and continuing to expand our product innovations to strengthen the overall*
 23 *position of the company."*

24 Terayon and the Audit Committee of Terayon's Board of Directors are working
 25 closely with the company's independent auditors in connection with the accounting
 26 review. In addition, the Audit Committee has decided to conduct an independent
 27 inquiry into the circumstances relating to the accounting treatment of certain of the
 28 transactions at issue with the assistance of independent legal counsel. The timing and
 possible outcome of the Audit Committee's inquiry cannot be predicted at this time.
 [Emphasis added.]

227. The November 7, 2006 release was false and misleading when made because it
 continued to conceal the true, adverse facts – known but concealed by defendants – that the
 Company's financial problems were not limited to issues regarding the improper recording of
 revenue relating to a single customer for two quarters in 2004 but rather sweeping issues relating to
 a need to restate the financials for nearly the entire Class Period and massive, overarching internal
 control problems.

228. As a result of defendants' failure to file the Company's quarterly Form 10-Q report,
 with the SEC within the prescribed time, on November 22, 2006, Terayon announced that it had
 received a letter from the Nasdaq Stock Market notifying the Company that Terayon's stock was

1 subject of delisting (for violation of Rule 4310(c)(14), that requires the timely filing of periodic
 2 reports with the SEC). Also, as a result of defendants' failures to make a timely Form 10-Q filing
 3 with the SEC, Terayon's trading symbol was changed to "TERNE" from "TERN," on or about
 4 November 21, 2005.

5 229. The Company's November 22, 2005 release also stated, in part, the following:

6 Terayon announced on November 7, 2005 its delay in filing the Form 10-Q as the
 7 company is reviewing the recognition of revenue for certain transactions during prior
 8 periods. Terayon initiated the review after determining that certain revenues
 9 recognized in the second half of fiscal year 2004 from a customer may have been
 10 recorded in incorrect periods. The revenue matters under examination relate to the
 11 timing of revenue recognition and may result in a restatement of prior period
 12 financials. Terayon cannot determine at this time when the investigation will be
 13 completed, but the company intends to file its Form 10-Q for the third quarter of
 14 2005 as soon as practicable following the conclusion of the investigation. The SEC
 15 has informed Terayon that it has initiated an informal inquiry into the matters
 16 discussed in the November 7, 2005 press release. Terayon intends to cooperate fully
 17 with the SEC's inquiry.

18 230. On January 10 2006, defendants published a release that provided a purported
 19 "update" on the Company's continuing accounting review, also announcing that Terayon had
 20 received a letter from the Nasdaq stating that the Commission had already began investigating:

21 **Terayon Provides Update on Accounting Review**

22 Company Also Receives Letter from NASDAQ Regarding its 2005 Shareholder
 23 Meeting

24 Terayon Communication Systems, Inc. (NASDAQ: TERNE), a leading provider of
 25 digital video networking applications and home access solutions, announced on
 26 November 7, 2005 that the filing of its Form 10-Q for the third quarter of 2005
 27 would be delayed and that it had commenced an accounting review after determining
 28 that certain revenues recognized in the second half of fiscal year 2004 may have been
 recorded in incorrect periods. The delayed filing of Terayon's Form 10-Q for the
 third quarter of 2005 caused Terayon to be in violation of NASDAQ Marketplace
 Rule 4310(c)(14), which requires the timely filing of periodic reports with the U.S.
 Securities and Exchange Commission (SEC). While steady progress has been made,
 Terayon cannot determine at this time when the accounting review will be
 completed. The company intends to file its Form 10-Q for the third quarter of 2005
 as soon as practicable following the conclusion of the accounting review.

*In addition, as a result of the delay in the filing of its Form 10-Q for the quarterly
 period ended September 30, 2005, Terayon is not in compliance with its obligation
 under the Indenture with respect to Terayon's 5% Convertible Subordinated Notes
 due 2007 (Notes) to file with the SEC and the trustee of the Notes (Trustee) all
 reports, information and other documents required pursuant to Sections 13 or*

1 *15(d) of the Securities Exchange Act of 1934. If holders of at least 25% in*
 2 *aggregate principal amount of the Notes outstanding provide written notice to the*
 3 *Trustee or to Terayon and the Trustee of a default based on Terayon's failure to*
 4 *file its Form 10-Q Report for the quarterly period ended September 30, 2005 and*
 5 *such default is not cured within 60 days of such notice, an event of default will*
 6 *occur and the Trustee or holders of at least 25% in aggregate principal amount of*
 7 *the Notes then outstanding may accelerate the maturity of the Notes and declare*
 8 *the entire principal amount of the Notes, together with all accrued and unpaid*
 9 *interest thereon, to be due and payable immediately. The Notes currently*
 10 *outstanding have an aggregate principal amount of \$65 million. The company*
 11 *ended 2005 with \$101 million of Cash and cash equivalents plus Short-term*
 12 *investments. [Emphasis added].*

13 231. The Company's January 10, 2006 release also provided a purported "Update" on
 14 Terayon's trading status on the Nasdaq, in part, as follows:

15 **NASDAQ Update**

16 Terayon also announced today that it received a letter from The Nasdaq Stock
 17 Market (NASDAQ), dated January 4, 2006, notifying the company that its common
 18 stock is subject to delisting based on its failure to satisfy NASDAQ Marketplace
 19 Rules 4350(e) and 4350(g), which required the company to solicit proxies and hold
 20 an annual meeting of shareholders before December 31, 2005. Terayon held its 2004
 21 annual shareholder meeting in December 2004 and the company's 2005 annual
 22 shareholder meeting was originally planned for December 2005. However, Terayon
 23 was unable to hold its 2005 annual shareholder meeting due in part to its ongoing
 24 accounting review.

25 As previously disclosed on November 22, 2005, Terayon received a letter from
 26 NASDAQ, dated November 17, 2005, stating that as a result of Terayon's failure to
 27 timely file its Form 10-Q for the third quarter of 2005 with the SEC, Terayon's
 28 common stock is subject to delisting from the NASDAQ National Market. In
 response to the November 17, 2005 letter, Terayon requested a hearing with a
 NASDAQ Listing Qualifications Panel which automatically stayed the delisting
 action pending the issuance of a written decision from the Panel. Terayon presented
 its plan to evidence compliance with all NASDAQ listing criteria at a hearing before
 the Panel on December 15, 2005. Terayon has not yet received a determination from
 the Panel as a result of the hearing.

In NASDAQ's January 4, 2006 letter, Terayon was informed that the Panel will
 consider the company's failure to comply with NASDAQ's proxy solicitation and
 annual meeting requirements in rendering its decision regarding the continued listing
 of Terayon's common stock. Terayon discussed the proxy solicitation and annual
 meeting deficiencies with the Panel at the hearing on December 15, 2005 and plans
 to submit additional materials for the Panel's review with respect to those issues by
 the January 11, 2006 deadline. There can be no assurance that the Panel will grant the
 company's request for the continued listing of its common stock on the NASDAQ.

232. The same day, January 10, 2006, the *San Jose Business Journal* reported that defendants had warned of a possible \$65 million bond default. According to this report, the Company had stated that the delays in filing its financials may put it in default on \$65 million in bonds. As a result of this default, the Company's **5% Convertible Subordinated Notes due in 2007 become immediately payable if holders of at least 25% of the aggregate principal amount of the bonds provide written notice of a default that isn't cured within 60 days. Days later, on January 13, 2006, Terayon was served with notice of default from holders of over 25% of the outstanding Convertible Subordinated Notes.**

233. On January 26, 2006, defendants announced yet another purported "restructuring" – this time as a "pure play digital video company." That day, Terayon published another release that stated, in part, the following:

Terayon Restructures to Pure-Play Digital Video Company

Terayon Communication Systems, Inc. (NASDAQ: TERNE), a leading provider of video localization-on-demand solutions, today announced a restructuring to focus the company's strategy solely on its digital video applications and reduce its overall cost structure as a pure-play video business.

"Our decision to concentrate solely on digital video applications enables us to laser-focus the company on a growing market for real-time network digital video processing and expand our applications and services," said **Jerry Chase**, Terayon, CEO. "Network operators worldwide in cable, satellite, telco and mobile, understand that they must customize digital video programming services and advertising to become more relevant to their individual customers. The move to customizing content delivered the instant before viewing creates substantial opportunity for Terayon, particularly in the area of digital video advertising, as it builds on our existing core competencies and market leadership. Localizing services and advertising plays strongly to the core strength exhibited in our award winning CherryPicker® product line."

As part of the company's move to a pure-play video business, Terayon is reviewing strategic alternatives for its Home Access Solutions product line including the opportunity to monetize its current investment in working capital. As part of the restructuring, Terayon expects to record charges of approximately \$0.6 million for employee related costs in addition to other restructuring costs, the majority of which are expected to occur in the first quarter of 2006.

Chase continued, *"We are now structured to take advantage of what we do best. By focusing on digital video, we expect to drive our strategic goals of increased market penetration and improved financial performance. With the savings we obtain from the restructuring, we intend to allocate additional resources for digital video software application development to pursue new revenue-generating video opportunities.*

1 Through our focus and partnerships with key industry players and existing customer
 2 relationships in the cable, satellite and telco markets, ***Terayon is well positioned for
 success.*** [Emphasis added.]

3 234. The January 26, 2006 release was false and misleading because the restructuring
 4 move did not make the Company “well positioned for success” but was actually a last-ditch effort to
 5 spin a very negative situation quickly enveloping all aspects of the company – from financials, to
 6 internal controls, to performance and results – in a positive light despite the true fact that defendants
 7 well knew that massive financial and accounting improprieties were severely undermining the
 8 Company and its ability to function prospectively, and a massive restatement was both unavoidable
 9 and imminent.

10 **THE TRUE FINANCIAL AND OPERATIONAL**
 11 **CONDITION OF TERAYON IS BELATEDLY DISCLOSED**

12 235. On March 1, 2006, the last day of the Class Period, defendants finally revealed to
 13 investors the secret truth behind that Company’s reported purported successes: still more financial
 14 and accounting improprieties! That day, defendants published a release announcing that the Audit
 15 Committee of the Board of Directors of the Company had revealed that defendants artificially
 16 inflated the Company’s financial results in the prior periods and it concluded that ***Terayon’s***
 17 ***consolidated financial statements for the year ended December 31, 2004 and the first two***
 18 ***quarters of 2005 should no longer be relied upon and would be restated.*** This release stated, in
 19 part, the following:

20 **Terayon Announces Expected Restatement of Prior Periods**

21 Terayon Communication Systems, Inc. (NASDAQ: TERNE) today announced that
 22 the Audit Committee of the Board of Directors has concluded that the Company’s
 23 consolidated financial statements for the year ended December 31, 2004 and for the
 24 four quarters of 2004 and the first two quarters of 2005 should no longer be relied
 upon and will be restated. This conclusion was based in part on the final results of
 the previously announced Audit Committee inquiry. The inquiry focused on the
 circumstances surrounding the timing of revenue recognition in the second half of
 2004 from a customer of the Company

25 * * *

26 The Company has also reviewed its revenue recognition policies relating to the
 27 recognition of the sales of software and other products bundled with post customer
 service contracts and has considered the guidance under SOP 97-2, Financial
 28 Accounting Standards Board Technical Bulletin 90-1, “Accounting for Separately

1 Priced Extended Warranty and Product Maintenance Contracts,” as well as Financial
 2 Accounting Standards Board, Emerging Issues Task Force 00-21, “Accounting for
 3 Revenue Arrangements with Multiple Deliverables,” in relation to multiple-element
 4 revenue arrangements. Under this guidance management has determined that during
 5 2004, the Company did not establish vendor specific objective evidence for its post
 6 contract service revenue element as it related to digital video customer service.
 7 Consequently, management anticipates an additional deferral of revenue from each
 8 quarter of 2004 in which the revenue was recognized, in order to recognize the
 9 revenue from software bundled with post customer service contracts over the life of
 10 the customer service contract period.

11 * * *

12 The filing of the Company’s Form 10-Q for the quarter ended September 30, 2005
 13 will be further delayed pending the completion of the restated consolidated historical
 14 financial statements. Because of the delay in filing the Form 10-Q, the Company is
 15 not in compliance with The Nasdaq Stock Market’s continued listing requirement set
 16 forth in Nasdaq Marketplace Rule 4310(c)(14). As previously announced, the
 17 Company received letters from The Nasdaq Stock Market dated November 17, 2005
 18 and January 4, 2006 regarding the Company’s failure to file its Form 10-Q for the
 19 quarter ended September 30, 2005, and its failure to solicit proxies and hold an
 20 annual meeting of shareholders on or before December 31, 2005, respectively. On
 21 January 17, 2006, a NASDAQ Listing Qualifications Panel agreed to continue the
 22 listing of the Company’s common stock on The Nasdaq National Market subject to
 23 three conditions: (1) on or before January 31, 2006, the Company was required to
 24 provide NASDAQ with certain information related to the Audit Committee’s
 25 inquiry; (2) on or before March 31, 2006, the Company must file the Form 10-Q for
 26 the quarter ended September 30, 2005 and all required restatements; (3) on or before
 27 March 31, 2006, the Company must file the proxy statement for the 2005 annual
 28 meeting, with a record date set and a meeting to be held as soon thereafter as
 possible. While the Company provided NASDAQ with a response to questions
 relating to the internal accounting review on January 31, 2006 and is making every
 effort to comply with the remaining requirements, there can be no assurance that the
 Company will be able to do so within the Panel’s deadlines, or that the Company’s
 common stock will continue to be listed on the Nasdaq National Market.

29 ***Management and the Audit Committee have concluded that the restatement***
 30 ***constitutes a material weakness within the meaning of the PCAOB’s Audit***
 31 ***Standard No. 2. In addition to this material weakness, additional control***
 32 ***deficiencies may be identified which individually or in the aggregate may***
 33 ***constitute additional material weaknesses.*** Management and the Audit Committee
 34 are continuing to evaluate whether there are additional material weaknesses.

35 * * *

36 ***The Company previously announced in November 2005 that the SEC had initiated***
 37 ***an informal inquiry with regard to the subject matter of the Company’s accounting***
 38 ***review. The Company understands that the SEC has since issued a formal order***
 39 ***of investigation with regard to this matter.*** The Company has been and is continuing
 40 to cooperate fully with the SEC. [Emphasis added.]

236. The same day, the Company filed with the SEC pursuant to Form 8-K, a notice of Non-Reliance on Terayon's Previously Filed Financial Statements and Related Audit Reports, that stated, in part, the following:

Item 4.02(a). Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review

On March 1, 2006, the Audit Committee of the Board of Directors of Terayon Communication Systems, Inc. ("Terayon") concluded that the previously issued financial statements contained in Terayon's Annual Report on Form 10-K for the fiscal year ended December 31, 2004 and as of and for the four quarters of 2004 and the first two quarters of 2005 should no longer be relied upon. *Terayon expects to restate its financial statements for the above listed periods to correct errors identified in Terayon's revenue recognition practices and policies with respect to the timing of revenue recognition. The restatement will have no impact on Terayon's cash balances for the restated periods. The errors may also affect financial information relating to periods in addition to the periods described above and other matters besides revenue recognition.* [Emphasis added.]

237. Based on the huge disparity between defendants' prior guidance, the Company's past performance and the results announced by defendants that day, on March 1, 2006 Terayon stock declined precipitously – falling almost 15% in the single trading day, in regular trading, as exceptionally heavy trading volume of over 4 million Terayon shares traded.

Post Class Period Events that Further Confirm the Full Extent of Defendants' Fraud

238. Thereafter, after failing to file the Company's year end report with the SEC in a timely manner, by March 31, 2006, Terayon received a notice of delisting from the Nasdaq National Market Listing Qualifications Panel, stating that the Company's stock would be barred from trading on the Nasdaq National Market effective the opening of trading on April 4, 2006.

239. On May 26, 2006, defendants also published a release that stated that Terayon management was continuing to review the financial statements and the Company's revenue recognition policies to determine whether it will recommend to the Audit Committee of its Board of Directors, that the previously announced restatement of the Company's consolidated financial statements for 2004 would require additional restatements or audits for any prior periods, such as 2003. At that time, defendants stated that, *"there can be no assurance that management or the Company's independent auditor will not identify additional issues or other considerations in connection with the restatement and the audit and review process, or that these issues or*

1 *considerations will not require additional adjustments to the Company's prior financial results*
 2 *for annual or quarterly periods in addition to 2004."*

3 240. At the same time, defendants also stated that, "in light of the uncertainty over the
 4 timing of the completion of the restatements," the Company had withdrawn its appeal to the Nasdaq
 5 Listing and Hearing Review Council to review the Nasdaq Listing Qualifications Panel's March 31,
 6 2006 decision to delist the Company's securities from The Nasdaq National Market.

7 241. On June 19, 2006, Terayon also announced the resignation of defendant Slaven from
 8 the Board of Directors of the Company and from his positions as Chairman of the Audit Committee
 9 and member of the Nominating and Governance Committee, effective August 2, 2006. The
 10 Company also announced the resignation of Krstajic, effective immediately. At the time defendants
 11 announced these defections, the Company stated that Slaven had retired "as a result of the increased
 12 demands on his time from his duties as Senior Vice President, Chief Financial Officer and Treasurer
 13 of Cross Match Technologies Inc. in Palm Beach Gardens, Florida," and that Krstajic had resigned
 14 as a result of "increased travel and demands on his time from his duties as President and Chief
 15 Executive Officer of Bell Vanguard Inc."

16 242. On November 8, 2006, investors were further informed of the truly massive scope of
 17 defendants' fraudulent accounting scheme, after the Company published a release that belatedly
 18 revealed that investors could not rely on any of Terayon's financial statements *dating back to at*
 19 *least 2000!* This release stated, in part, the following:

20 Terayon Announces Expected Restatement of Financial Statements
 21 Wednesday November 8, 8:00 am ET

22 SANTA CLARA, Calif., Nov. 8 /PRNewswire-FirstCall/ – Terayon Communication
 23 Systems, Inc. (Pink Sheets: TERN.PK - News) today announced that the Audit
 24 Committee of the Board of Directors, upon the recommendation of management, has
 25 concluded that the Company's consolidated financial statements for the years ended
 26 December 31, 2003, 2002 and 2000 and for the quarters of 2003, 2002 and 2000
 27 should no longer be relied upon. The restatement of financial statements for 2003
 28 will correct errors primarily relating to the recognition of revenue, cost of goods sold
 and estimates of reserves. The restatement of financial statements for 2000 and 2002
 will correct errors primarily relating to the need to separately value and account for
 an embedded derivative option associated with the Company's 5% convertible
 subordinated notes issued in July 2000, and other accrual estimates. While no
 determination was made that the financial statements for 2001 cannot be relied upon,
 adjustments will be made to 2001 that will be reflected in the financial statements

1 that the Company will include in its periodic reports to be filed with the Securities
2 and Exchange Commission. Management currently expects the audit, re-audit and
3 restatement process, as well as the filings of its periodic reports with restated
financial statements, to be completed by the end of the 2006 calendar year.

4 The Audit Committee's determination represents the completion of the Company's
5 previously announced review of accounting policies and practices for periods prior to
6 2004. In March 2006, the Company announced that it will restate its consolidated
financial statements for the year ended December 31, 2004, and for the four quarters
of 2004 and the first two quarters of 2005. The restatements are not expected to
affect reported cash balances for any restated period.

7 243. On December 29, 2006, the Company filed its latest 10-K which disclosed the
8 sweeping Restatement that the Company had hinted at in March and then November of 2006. The
9 Restatement process, as reflected in the 10-K, included a restatement of financials for the years
10 ended December 31, 2004, December 31, 2003, and December 31, 2002. The Restatement also
11 included adjusted financial statements for the year ended December 13, 2001. The first two quarters
12 of 2005 and the quarterly information for all four quarters of 2004 were also restated.

13 244. The 10-K is incorporated herein by reference and includes admissions concerning
14 massive financial improprieties, including improper revenue recognition, failure to properly account
15 for reserves and doubtful accounts, myriad GAAP violations, and major internal control weaknesses
16 during the Class Period. Among the disclosures contained in that Form 10-K are the following:

17 * ***Improper Recognition of Deferred Revenue:***

18 – The Company did not properly account for deferred revenue and related cost of goods
19 sold. For example, the Company did not sufficiently evaluate its video products and improperly
20 accounted for them in accordance with the revenue recognition criteria in SAB 104 when revenue
21 should have been accounted for in accordance with the software revenue recognition principles
22 under SOP 97-2 – which requires the Company to establish vendor specific objective evidence of
23 fair value for each element within a multiple element arrangement. As part of the Restatement
24 process, revenue and cost of goods sold previously recognized based on meeting the criteria in SAB
25 104 for the individual elements for digital video products sold in conjunction with PCS in each
26 quarter of 2003, 2004, and 2005 were deferred and recognized ratably over the contract service
27 period.

28

1 – The Company was required to make various additional adjustments in 2003, 2004, and
2 2005 to correct the recognition of revenue for transactions where the Company did not properly
3 apply SAB 101, as amended by SAB 104. As part of Restatement process, the Company
4 determined that it did not properly account for deferred revenue as it related to specific transactions
5 to certain customers where transactions did not satisfy revenue recognition criteria of SAB 104
6 related to customers where the arrangement fee was not fixed or determinable or customers where
7 collectibility was not reasonably assured. The Company improperly recognized a deferred revenue
8 liability and a deferred cost of goods sold asset, thereby overstating assets and liabilities, and during
9 the Restatement determined that deferred revenues and deferred cost of goods should not be
10 recognized for these transactions. As a result, the Company adjusted deferred revenues by \$1.6
11 million, \$1.0 million and \$0.9 million for the years ended 2003 and 2004 and the first two quarters
12 of 2005, respectively, and adjusted deferred cost of goods sold by \$0.9 million, \$0.3 million, and
13 \$0.6 million for the years ended 2003 and 2004 and for the first two quarters of 2005.

14 * ***Improper Revenue Recognition Concerning Thomson Broadcast:*** The Company also did not
15 account for a significant transaction whereby it developed a broadcast platform based on its DM
16 6400 product to sell to its customer Thomson Broadcast. As a result, revenue was improperly and
17 prematurely recognized in violation of SOP 97-2, and in violation of SOP 81-1, which sets forth
18 criteria for completed contract recognition. As a result, \$7.8 million of revenue previously
19 recognized in 2004 and \$1.8 million related to direct development costs previously recognized from
20 the fourth quarter of 2003 through the second quarter of 2005 were also deferred and ultimately
21 recognized in the quarter ended December 31, 2005.

22 * ***Improper Allowance for Doubtful Accounts:*** The Company was required to reassess its
23 allowance for doubtful accounts which contained various material errors in the pre-2004
24 methodology. During the Restatement, the Company adjusted the allowance for doubtful accounts
25 and bad debt with a reduction of \$5.2 million, an increase of \$1.9 million and an increase of \$0.6
26 million for the years ended December 31, 2000, 2001, and 2002, respectively. The Company made
27 adjustments to the allowance for doubtful accounts of \$0.1 million, \$0.6 million, and \$0.3 million
28 for the years ended December 31, 2003 and 2004 and the first two quarters of 2005, respectively.

1 The Company also, during the Restatement, made other adjustments to doubtful accounts to offset
2 accounts receivable and related reserve concerning customers where collectibility was not
3 reasonably assured, eliminative the receivable and related reserve for these customers by an increase
4 of \$5.7 million, a decrease of \$4.4 million for years ended December 31, 2003 and 2004 and the
5 first two quarters of 2005. In summary, the above restatements gave rise to an adjustment to the
6 allowance for doubtful accounts of an increase of \$5.8 million, a decrease of \$3.8 million and an
7 increase of \$0.3 million for the years ended December 31, 2003 and 2004 and the first two quarters
8 of 2005, respectively.

9 * **Reserves related to Restructuring:** The Company did not effectively monitor and adjust reserves
10 related to its restructuring charges. For example, a portion of certain leased facilities in Israel had
11 restructuring reserves exceeding the amount due under the lease. The Company also over accrued
12 reserves related to legal fees, taxes and other liabilities owed to third party vendors.

13 * **Inadequate Personnel:** The Company did not have adequate personnel in its accounting and
14 financial department, and additionally lacked sufficient qualified accounting and finance personnel
15 to identify and resolve complex accounting issues in accordance with GAAP.

16 * **Inadequate Control:** The Company did not have adequate internal control over financial
17 reporting, including: (i) insufficient controls related to identification, capture, and timely
18 communication of financially significant information between certain parts of the organization and
19 the accounting and finance department to enable accounting for transactions in a complete and
20 timely manner; (ii) lack of sufficient personnel with technical accounting expertise in the accounting
21 and finance department and inadequate review and approval procedures to prepare external financial
22 statements in accordance with GAAP; (iii) failure to properly recognize revenue in accordance with
23 GAAP, including revenue recognized in accordance with the following principles: Statement of
24 Position ("SOP") 97-2, "Software Revenue Recognition;" Staff Accounting Bulletin ("SAB") No.
25 101, "Revenue Recognition," as amended by SAB 104; "Accounting for Performance of
26 Construction Type and Certain Production-Type Contracts" (SOP 81-1); and Financial Accounting
27 Standards Board, Emerging Issues Task Force (EITF) 00-21, "Accounting for Revenue
28 Arrangements with Multiple Deliverables; (iv) improper use of estimates, including monitoring and

1 adjustment balances related to certain accruals and reserves, including allowance for doubtful
2 accounts, legal charges, license fees, restructuring charges, taxes, warranty obligations and fixed
3 assets; (v) lack of sufficient analysis and documentation of the application of GAAP; and (vi)
4 ineffective controls over the documentation, authorization and review of manual journal entries and
5 ineffective controls to ensure the accuracy and completeness of certain general ledger account
6 reconciliations conducted in connection with period end financial reporting.

7 * Finally, the Company's Convertible Subordinated Notes contained several imbedded derivatives.
8 First, the Notes contain a contingent put where in the even of any default by the Company, the
9 Trustee or holders of at least 25% of the principal amount of the Notes outstanding may declare all
10 unpaid principal and interest to be due and immediately payable. In fact, this provision was
11 triggered and the Company was forced to pay off the entire principal amount for a total of \$65.6
12 million in the quarter ending March 31, 2006. This provision was not disclosed to investors until it
13 was revealed to the market by a California newspaper in January 2006. Two additional embedded
14 derivatives – an investor conversion option and a liquidated damages provision – did not comply
15 with SFAS 133, which requires that an embedded derivative must be separated from its host
16 contract (i.e., the Notes) and accounted for as a stand-alone derivative if the economic
17 characteristics and risks of the embedded derivative would not be considered clearly and closely
18 related to the host contract.

19 **EFFICIENT MARKET ALLEGATIONS: PRESUMPTION OF RELIANCE**

20 245. Throughout the Class Period, the market for Terayon's common stock was an
21 efficient market for the following reasons, among others:

- 22 a. Terayon's stock met the requirements for listing, and was listed and actively
23 traded on the Nasdaq national market exchange, a highly efficient and automated market;
- 24 b. As a regulated issuer, Terayon filed periodic public reports with the SEC and
25 the Nasdaq;
- 26 c. Terayon regularly communicated with public investors *via* established market
27 communication mechanisms, including regular disseminations of press releases on the national
28

1 circuits of major newswire services and through other wide-ranging public disclosures, such as
2 communications with the financial press and other similar reporting services; and

3 d. Terayon was followed by several securities analysts employed by major
4 brokerage firm(s) who wrote reports which were distributed to the sales force and certain customers
5 of their respective brokerage firm(s). Each of these reports was publicly available and entered the
6 public marketplace.

7 246. As a result of the foregoing, the market for Terayon securities promptly digested
8 current information regarding Terayon from all publicly available sources and reflected such
9 information in Terayon stock price. Under these circumstances, all purchasers of Terayon common
10 stock during the Class Period suffered similar injury through their purchase of Terayon common
11 stock at artificially-inflated prices and a presumption of reliance applies.

12 CAUSATION AND ECONOMIC LOSS

13 247. During the Class Period, as detailed herein, defendants engaged in a scheme to
14 deceive the market, and a course of conduct that artificially inflated Terayon's stock price and
15 operated as a fraud or deceit on Class Period purchasers of Terayon's stock by misrepresenting the
16 Company's financial results and by improperly recognizing revenues. Defendants improperly
17 inflated the Company's financial results by making false and misleading statements about the
18 Company and by filing false financial statements with the SEC.

19 248. Ultimately, however, when defendants' prior misrepresentations and fraudulent
20 conduct came to be revealed to investors, shares of Terayon declined precipitously – evidence that
21 the prior artificial inflation in the price of Terayon's shares was eradicated. As a result of their
22 purchases of Terayon stock during the Class Period, Plaintiff and other members of the Class
23 suffered economic losses, *i.e.* damages under the federal securities laws.

24 249. By improperly characterizing the Company's financial results and misrepresenting its
25 prospects, defendants presented a misleading image of Terayon's business and growth prospects.
26 During the Class Period, defendants repeatedly emphasized the ability of the Company to monitor
27 and control its operations and financial reporting, and consistently reported results within the range
28 of guidance sponsored or endorsed by the Company. These claims caused and maintained the

1 artificial inflation in Terayon's stock price throughout the Class Period and until the truth about the
2 Company was ultimately revealed to investors.

3 250. As a direct result of defendants' statements on March 1, 2006, that the Company
4 would be forced to restate its financial results and take significant, and yet undetermined, charges
5 for at least the periods of 2004 through the first half of 2005, and probably longer, Terayon's stock
6 price declined over 13% in the single trading day, compared to the trading price prior to news of
7 defendants' illegal and improper accounting scheme reached the market. This dramatic share price
8 decline, eliminated much of the artificial inflation from Terayon's share price, causing real
9 economic loss to investors who purchased this stock during the Class Period.

10 251. In sum, as the truth about defendants' fraud and illegal course of conduct became
11 known to investors, and as the artificial inflation in the price of Terayon shares was eliminated,
12 Plaintiff and the other members of the Class were damaged, suffering direct economic loss.

13 252. The decline in Terayon's stock price at the end of the Class Period was a direct result
14 of defendants' fraud being revealed to investors and the market. The timing and magnitude of
15 Terayon's stock price decline negates any inference that the losses suffered by Plaintiff and the other
16 members of the Class was caused by changed market conditions, macroeconomic or industry factors
17 or even Company-specific facts unrelated to defendants' fraudulent conduct. When Terayon's share
18 price fell over 13% as a result of defendants fraud being revealed, the Standard & Poor's 500
19 securities index was relatively unchanged.

20 253. The economic loss, *i.e.* damages suffered by Plaintiff and other members of the
21 Class, was a direct result of defendants' fraudulent scheme to artificially inflate the price of
22 Terayon's stock and the subsequent significant decline in the value of the Company's shares when
23 defendants' prior misstatements and other fraudulent conduct was revealed.

24 **VIOLATIONS OF GAAP AND SEC REPORTING RULES**

25 254. During the Class Period, defendants materially misled the investing public, thereby
26 inflating the price of the Company's securities, by publicly issuing false and misleading statements
27 and omitting to disclose material facts necessary to make defendants' statements, as set forth herein,
28 not false and misleading. Said statements and omissions were materially false and misleading in that

1 they failed to disclose material adverse information and misrepresented the truth about the
2 Company, its financial performance, accounting, reporting, and financial condition in violation of
3 the federal securities laws and GAAP.

4 255. GAAP consists of those principles recognized by the accounting profession as the
5 conventions, rules, and procedures necessary to define accepted accounting practice at the particular
6 time. Regulation S-X, to which the Company is subject as a registrant under the Exchange Act, 17
7 C.F.R. 210.4-01(a)(1), provides that financial statements filed with the SEC which are not prepared
8 in compliance with GAAP, are presumed to be misleading and inaccurate. SEC Rule 13a-13
9 requires issuers to file quarterly reports.

10 256. SEC Rule 12b-20 requires that periodic reports contain such further information as is
11 necessary to make the required statements, in light of the circumstances under which they are made,
12 not misleading.

13 257. In addition, Item 303 of Regulation S-K requires that, for interim periods, the
14 Management Division and Analysis Section ("MD&A") must include, among other things, a
15 discussion of any material changes in the registrant's results of operations with respect to the most
16 recent fiscal year-to-date period for which an income statement is provided. Instructions to Item
17 303 require that the this discussion identify any significant elements of registrant's income or loss
18 from continuing operations that are not necessarily representative of the registrant's ongoing
19 business. Item 303(a)(2)(ii) to Regulation S-K requires the following discussion in the MD&A of a
20 company's publicly filed reports with the SEC:

21 Describe any known trends or uncertainties that have had or that the registrant
22 reasonably expects will have a material favorable or unfavorable impact on net sales
23 or revenues or income from continuing operations. If the registrant knows of events
24 that will cause a material change in the relationship between costs and revenues
(such as known future increases in costs of labor or materials or price increases or
inventory adjustments), the change in relationship shall be disclosed.

25 Paragraph 3 of the Instructions to Item 303 states in relevant part:

26 The discussion and analysis shall focus specifically on material events and
27 uncertainties known to management that would cause reported financial information
28 not to be necessarily indicative of future operating results or of future financial
condition. This would include descriptions and amounts of (A) matters that would
have an impact on future operations and have not had an impact in the past. . . .

1 258. The GAAP requirement for recognition of an adequate provision for foreseeable
2 costs and an associated allowance applies to interim financial statements as required by Accounting
3 Principles Board Opinion No. 28. Paragraph 17 of this authoritative pronouncement states that:

4 The amounts of certain costs and expenses are frequently subjected to year-end
5 adjustments even though they can be reasonably approximated at interim dates. To
6 the extent possible such adjustments should be estimated and the estimated costs and
expenses assigned to interim periods so that the interim periods bear a reasonable
portion of the anticipated annual amount.

7 259. The Company's financial statements contained in the fiscal 2004 Form 10-K and/or
8 the quarterly reports filed with the SEC on Forms 10-Q for the quarterly periods throughout the
9 Class Period were presented in a manner that violated the principle of fair financial reporting and
10 the following GAAP, among others:

11 a. The principle that financial reporting should provide information that is
12 useful to present and potential investors and creditors and other users in making rational investment,
13 credit and similar decisions (FASB Statement of Concepts No. 1).

14 b. The principle that financial reporting should provide information about an
15 enterprise's financial performance during a period (FASB Statement of Concepts No. 1).

16 c. The principle that financial reporting should be reliable in that it represents
17 what it purports to represent (FASB Statement of Concepts No. 2).

18 d. The principle of completeness, which means that nothing material is left out
19 of the information that may be necessary to ensure that it validly represents underlying events and
20 conditions (FASB Statement of Concepts No. 2).

21 e. The principle that conservatism be used as a prudent reaction to uncertainty to
22 try to ensure that uncertainties and risks inherent in business situations are adequately considered
23 (FASB Statement of Concepts No. 2).

24 f. The principle that contingencies and other uncertainties that affect the
25 fairness of presentation of financial data at an interim date shall be disclosed in interim reports in
26 the same manner required for annual reports (APB Opinion No. 28).

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1 g. The principle that disclosures of contingencies shall be repeated in interim
2 and annual reports until the contingencies and have been removed, resolved, or have become
3 immaterial (APB Opinion No. 28).

4 h. The principle that management should provide commentary relating to the
5 effects of significant events upon the interim financial results (APB Opinion No. 28).

6 260. In addition, during the Class Period, defendants violated SEC disclosure rules:

7 a. defendants failed to disclose the existence of known trends, events or
8 uncertainties that they reasonably expected would have a material, unfavorable impact on net
9 revenues or income or that were reasonably likely to result in the Company's liquidity decreasing in
10 a material way, in violation of Item 303 of Regulation S-K under the federal securities laws (17
11 C.F.R. 229.303), and that failure to disclose the information rendered the statements that were made
12 during the Class Period materially false and misleading; and

13 b. by failing to file financial statements with the SEC that conformed to the
14 requirements of GAAP, such financial statements were presumptively misleading and inaccurate
15 pursuant to Regulation S-X, 17 C.F.R. 210.4-01(a)(1).

16 261. Defendants were required to disclose, in the Company's financial statements, the
17 existence of the material facts described herein and to appropriately recognize and report assets,
18 revenues, and expenses in conformity with GAAP. The Company failed to make such disclosures
19 and to account for and to report its financial statements in conformity with GAAP. Defendants
20 knew, or were reckless in not knowing, the facts which indicated that the fiscal 2004 Form 10-K and
21 all of the Company's interim financial statements, press releases, public statements, and filings with
22 the SEC, which were disseminated to the investing public during the Class Period, were materially
23 false and misleading for the reasons set forth herein. Had the true financial position and results of
24 operations of the Company been disclosed during the Class period, the Company's common stock
25 would have traded at prices well below that which it did.

26 **ADDITIONAL SCIENTER ALLEGATIONS**

27 262. As alleged herein, defendants acted with scienter in that each defendant knew that the
28 public documents and statements issued or disseminated in the name of the Company were

1 materially false and misleading; knew that such statements or documents would be issued or
 2 disseminated to the investing public; and knowingly and substantially participated or acquiesced in
 3 the issuance or dissemination of such statements or documents as primary violations of the federal
 4 securities laws. As set forth elsewhere herein in detail, defendants, by virtue of their receipt of
 5 information reflecting the true facts regarding Terayon, their control over, and/or receipt and/or
 6 modification of Terayon's allegedly materially misleading misstatements and/or their associations
 7 with the Company which made them privy to confidential proprietary information concerning
 8 Terayon, participated in the fraudulent scheme alleged herein.

9 263. Defendants were motivated to materially misrepresent to the SEC and investors the
 10 true financial condition of the Company because: (i) it enabled them to deceive the investing public
 11 regarding Terayon's business, operations, management and the intrinsic value of Terayon common
 12 stock; (ii) it enabled defendants to artificially inflate the price of Terayon common stock; (iii) *it*
 13 *enabled Terayon insiders to sell approximately four million dollars worth of their privately- held*
 14 *Terayon shares while in possession of material adverse non-public information about the*
 15 *Company*; and (iv) it caused Plaintiff and other members of the Class to purchase Terayon common
 16 stock at artificially-inflated prices and to be damaged, thereby.

17 264. The insider stock sales by defendants which occurred within the Class Period are set
 18 forth below:

19	Defendant	Date	No. of Shares	Price/Share	Value
20	Zaki Rakib	2/17/05	150,000	\$3.53	\$530,145
21	Shlomo Rakib	2/17/05	150,000	\$3.53	\$530,145
22	Carol Lustenader	3/4/02-/8/02	5,747	\$6.56-7.57	\$39,138
23	Carol Lustenader	5/6/03	7,132	\$2.50	\$17,830
24	Carol Lustenader	7/2/03-7/3/03	50,000	\$2.94-3.63	\$167,700
25	Carol Lustenader	8/20/03	75,950	\$6.97	\$529,372
26	Christopher Schaepe	10/29/01- 10/31/01	57,610	\$11.35-11.80	\$662,923
27	Christopher Schaepe	11/1/01	62,500	\$11.08	\$692,500
28	Christopher Schaepe	2/1/02-2/13/02	80,345	\$6.83-\$7.03	\$548,832

Defendant	Date	No. of Shares	Price/Share	Value
Christopher Schaepe	3/6/02	20,775	\$6.83	\$141,893
Christopher Schaepe	11/3/03	2,800	\$6.89-6.98	\$19,313
Christopher Schaepe	10/31/03	5,400	\$6.84	\$36,945
TOTAL		668,259		\$3,916,736

PLAINTIFF'S CLASS ACTION ALLEGATIONS

265. Lead Plaintiff brings this action as a class action pursuant to Federal Rule of Civil Procedure 23(a) and (b)(3) on behalf of a Class, consisting of all those who purchased or otherwise acquired the common stock of Terayon between June 28, 2001 and March 1, 2006, inclusive and who were damaged thereby (the "Class"). Excluded from the Class are defendants, members of their immediate families and their legal representatives, heirs, successors or assigns and any entity in which defendants have or had a controlling interest.

266. The members of the Class are so numerous that joinder of all members is impracticable. Throughout the Class Period, Terayon common shares were actively traded on the Nasdaq. As of October 31, 2004, the Company had over 76 million shares of common stock issued and outstanding. While the exact number of Class members is unknown to Plaintiff at this time and can only be ascertained through appropriate discovery, Plaintiff believes that there are hundreds or thousands of members in the proposed Class. Record owners and other members of the Class may be identified from records maintained by Terayon or its transfer agent and may be notified of the pendency of this action by mail, using the form of notice similar to that customarily used in securities class actions.

267. Plaintiff's claims are typical of the claims of the members of the Class as all members of the Class are similarly affected by defendants' wrongful conduct in violation of federal law that is complained of herein.

268. Plaintiff will fairly and adequately protect the interests of the members of the Class and has retained counsel competent and experienced in class and securities litigation.

1 regarding Terayon's business, operations, management and the intrinsic value of Terayon common
2 stock; (ii) enable defendants to artificially inflate the price of Terayon common stock; (iii) enable
3 Terayon insiders to sell nearly four million dollars of their privately-held Terayon shares while in
4 possession of material adverse non-public information about the Company; and (iv) cause Plaintiff
5 and other members of the Class to purchase Terayon common stock at artificially inflated prices and
6 to be damaged, thereby. In furtherance of this unlawful scheme, plan and course of conduct,
7 defendants, jointly and individually (and each of them) took the actions set forth herein.

8 274. Defendants: (a) employed devices, schemes, and artifices to defraud; (b) made untrue
9 statements of material fact and/or omitted to state material facts necessary to make the statements
10 not misleading; and (c) engaged in acts, practices, and a course of business which operated as a
11 fraud and deceit upon the purchasers of the Company's common stock in an effort to maintain
12 artificially high market prices for Terayon's common stock in violation of Section 10(b) of the
13 Exchange Act and Rule 10b-5. All defendants are sued either as primary participants in the
14 wrongful and illegal conduct charged herein or as controlling persons as alleged below.

15 275. Defendants, individually and in concert, directly and indirectly, by the use, means or
16 instrumentalities of interstate commerce and/or of the mails, engaged and participated in a
17 continuous course of conduct to conceal adverse material information about the business, operations
18 and future prospects of Terayon as specified herein.

19 276. These defendants employed devices, schemes and artifices to defraud, while in
20 possession of material adverse non-public information and engaged in acts, practices, and a course
21 of conduct as alleged herein in an effort to assure investors of Terayon's value and performance and
22 continued substantial growth, which included the making of, or the participation in the making of,
23 untrue statements of material facts and omitting to state material facts necessary in order to make
24 the statements made about Terayon and its business operations and future prospects in the light of
25 the circumstances under which they were made, not misleading, as set forth more particularly
26 herein, and engaged in transactions, practices and a course of business which operated as a fraud and
27 deceit upon the purchasers of Terayon common stock during the Class Period.

28

1 277. Each of the Individual Defendants' primary liability, and controlling-person liability,
2 arises from the following facts: (i) the Individual Defendants were high-level executives and/or
3 directors at the Company during the Class Period and members of the Company's management team
4 or had control thereof; (ii) each of these defendants, by virtue of his responsibilities and activities as
5 a senior officer and/or director of the Company was privy to and participated in the creation,
6 development and reporting of the Company's internal budgets, plans, projections and/or reports;
7 (iii) each of these defendants enjoyed significant personal contact and familiarity with the other
8 defendants and was advised of and had access to other members of the Company's management
9 team, internal reports and other data and information about the Company's finances, operations, and
10 sales at all relevant times; and (iv) each of these defendants was aware of the Company's
11 dissemination of information to the investing public which they knew or recklessly disregarded was
12 materially false and misleading.

13 278. The defendants had actual knowledge of the misrepresentations and omissions of
14 material facts set forth herein, or acted with deliberate disregard for the truth in that they failed to
15 ascertain and to disclose such facts. Such defendants' material misrepresentations and/or omissions
16 were done knowingly or recklessly to conceal Terayon's operating condition and future business
17 prospects from the investing public and supporting the artificially inflated price of its common
18 stock. As demonstrated by defendants' overstatements and misstatements of the Company's
19 business, operations and earnings throughout the Class Period, defendants, if they did not have
20 actual knowledge of the misrepresentations and omissions alleged, were deliberate in failing to
21 obtain such knowledge by deliberately refraining from taking those steps necessary to discover
22 whether those statements were false or misleading.

23 279. As a result of the dissemination of the materially false and misleading information
24 and failure to disclose material facts, as set forth above, the market price of Terayon common stock
25 was artificially inflated during the Class Period. In ignorance of the fact that market prices of
26 Terayon's publicly traded common stock were artificially inflated, and relying directly or indirectly
27 on the false and misleading statements made by defendants, or upon the integrity of the market in
28 which the securities trade, and/or on the absence of material adverse information that was known to

1 or recklessly disregarded by defendants but not disclosed in public statements by defendants during
2 the Class Period, Plaintiff and the other members of the Class acquired Terayon common stock
3 during the Class Period at artificially-high prices and were damaged thereby.

4 280. At the time of said misrepresentations and omissions, Plaintiff and other members of
5 the Class were ignorant of their falsity, and believed them to be true. Had Plaintiff and the other
6 members of the Class and the marketplace known the truth regarding the problems that Terayon was
7 experiencing, which were not disclosed by defendants, Plaintiff and other members of the Class
8 would not have purchased or otherwise acquired their Terayon common stock, or, if they had
9 acquired such common stock during the Class Period, they would not have done so at the artificially
10 inflated prices which they paid.

11 281. By virtue of the foregoing, defendants have violated Section 10(b) of the Exchange
12 Act, and Rule 10b-5 promulgated thereunder.

13 282. As a direct and proximate result of defendants' wrongful conduct, Plaintiff and the
14 other members of the Class suffered damages in connection with their respective purchases and
15 sales of the Company's common stock during the Class Period.

16 **COUNT II**
17 **Violation Of Section 20(a) Of**
18 **The Exchange Act Against the Individual Defendants**

18 283. Plaintiff repeats every allegation contained above as if fully set forth herein.

19 284. The Individual Defendants acted as controlling persons of Terayon within the
20 meaning of Section 20(a) of the Exchange Act as alleged herein. By virtue of their high-level
21 positions, and their ownership and contractual rights, participation in and/or awareness of the
22 Company's operations and/or intimate knowledge of the false financial statements filed by the
23 Company with the SEC and disseminated to the investing public, the Individual Defendants had the
24 power to influence and control and did influence and control, directly or indirectly, the decision-
25 making of the Company, including the content and dissemination of the various statements which
26 Plaintiff contends are false and misleading. The Individual Defendants were provided with or had
27 unlimited access to copies of the Company's reports, press releases, public filings and other
28 statements alleged by Plaintiff to be misleading prior to and/or shortly after these statements were

1 issued and had the ability to prevent the issuance of the statements or cause the statements to be
2 corrected.

3 285. In particular, each of these defendants had direct and supervisory involvement in the
4 day-to-day operations of the Company and, therefore, is presumed to have had the power to control
5 or influence the particular transactions giving rise to the securities violations as alleged herein, and
6 exercised the same.

7 286. As set forth above, Terayon and the Individual Defendants each violated Section
8 10(b) and Rule 10b-5 by their acts and omissions as alleged in this Complaint. By virtue of their
9 positions as controlling persons, the Individual Defendants are liable pursuant to Section 20(a) of
10 the Exchange Act. As a direct and proximate result of defendants' wrongful conduct, Plaintiff and
11 other members of the Class suffered damages in connection with their purchases of the Company's
12 common stock during the Class Period.

13 **WHEREFORE**, Plaintiff prays for relief and judgment, as follows:

14 A. Determining that this action is a proper class action, and certifying Plaintiff as a class
15 representative under Rule 23 of the Federal Rules of Civil Procedure;

16 B. Awarding compensatory damages in favor of Plaintiff and the other Class members
17 against all defendants, jointly and severally, for all damages sustained as a result of defendants'
18 wrongdoing, in an amount to be proven at trial, including interest thereon;

19 C. Awarding Plaintiff and the Class their reasonable costs and expenses incurred in this
20 action, including counsel fees and expert fees;

21 D. Awarding extraordinary, equitable and/or injunctive relief as permitted by law, equity
22 and the federal statutory provisions sued hereunder, pursuant to Rules 64 and 65 and any appropriate
23 state law remedies to assure that the Class has an effective remedy; and

24 E. Such other and further relief as the Court may deem just and proper.

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JURY TRIAL DEMANDED

Plaintiff hereby demands a trial by jury.

Dated: January 8, 2007

Michael D. Braun
BRAUN LAW GROUP, P.C.

By: /S/
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PROOF OF SERVICE

STATE OF CALIFORNIA)
)ss.:
COUNTY OF LOS ANGELES)

I am employed in the county of Los Angeles, State of California, I am over the age of 18 and not a party to the within action; my business address is 12400 Wilshire Boulevard, Suite 920, Los Angeles, CA 90025.

On January 8, 2007, using the Northern District of California's Electronic Case Filing System, with the ECF ID registered to Michael D. Braun, I filed and served the document(s) described as:

AMENDED CLASS ACTION COMPLAINT FOR VIOLATIONS OF FEDERAL SECURITIES LAWS

The ECF System is designed to automatically generate an e-mail message to all parties in the case, which constitutes service. According to the ECF/PACER system, for this case, the parties served are as follows:

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Attorneys for Defendants

On January 8, 2007, I served the document(s) described as:

AMENDED CLASS ACTION COMPLAINT FOR VIOLATIONS OF FEDERAL SECURITIES LAWS

by placing a true copy(ies) thereof enclosed in a sealed envelope(s) addressed as follows:

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16 **Defendants**

17 I served the above document(s) as follows:

18 BY MAIL. I am familiar with the firm's practice of collection and processing
19 correspondence for mailing. Under that practice it would be deposited with U.S. postal service on
that same day with postage thereon fully prepaid at Los Angeles, California in the ordinary course of
20 business. I am aware that on motion of the party served, service is presumed invalid if postal
cancellation date or postage meter date is more than one day after date of deposit for mailing in an
21 affidavit.

22 I declare, pursuant to Civil L.R. 23-2, that on the date hereof I served a copy of the above-
listed document(s) on the Securities Class Action Clearinghouse by electronic mail through the
23 following electronic mail address provided by the Securities Class Action Clearinghouse:

24 **scac@law.stanford.edu**

25 I am employed in the office of a member of the bar of this Court at whose direction the
service was made.
26
27
28

1 I declare under penalty of perjury under the laws of the United States that the above is true
2 and correct.

3 Executed on January 8, 2007, at Los Angeles, California 90025.
4

5 /S/ LEITZA MOLINAR
6 Leitza Molinar
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